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SUBJECT: ECONOMIC GROWTH UNLIKELY UNTIL RESOLUTION OF  
MAOIST INSURGENCY

REFS: A. KATHMANDU 2251

[1](#)B. KATHMANDU 1920  
[1](#)C. KATHMANDU 2268  
[1](#)D. KATHMANDU 26

SUMMARY  
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[1](#)1. (SBU) During a recent visit to Nepal, two INR economic analysts gained insight into Nepal's poor economic state. Industrialists in Kathmandu and the key border town of Birgunj explained how Maoist extortion and the activities of Maoist-affiliated trade unions had greatly disrupted their enterprises. Entrepreneurs also complained that the Government of Nepal (GON) had yet to take any action against the Maoists to rectify the situation. Business leaders asserted that the solution to the country's economic woes was up to the politicians. They had surprisingly few opinions on the type of policies needed to mend the economy. The head of the three-member panel the GON tasked with formulating a plan to handle the petroleum price crisis stressed that the GON lacked the political will to bring local prices in line with market prices. In the absence of political stability, economic growth in Nepal is likely to remain low.

MAOISTS' EXORTING, NO GON PROTECTION  
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[1](#)2. (SBU) Visiting INR analysts were told by nearly everyone they met that the GON was not protecting businesses from Maoist extortion and Maoist-fostered labor unrest. According to Narendra Raj Poudel, the Chief District Officer (CDO) in Birgunj (key town on the border with India), the Home Ministry had given no direction to him or the local police to protect businesses or factories because the GON did not want to be seen as breaking the cease-fire. He added that he had recently been transferred to Birgunj from Chitwan (north-west of Birgunj), where he said the situation was the same. Businessmen did not appear to be taking any initiative to provide their own security.

[1](#)3. (SBU) Several business owners openly admitted to paying off the Maoists. In the Kathmandu area, owners said the

Maoists and their fronts were disciplined and kept reasonably good records so that they weren't hit up "too often." Owners in Birgunj disagreed, complaining that the solicitations were constant and the various Maoist groups took no account of "receipts" issued by other Maoist groups.

#### MAOISTS ENGAGED IN UNION BUSTING

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¶4. (SBU) More damaging than the extortion, however, were Maoist efforts to politicize the labor unions. Business leaders explained that to attract public support, Maoists would show up at factories and demand wage and benefit increases on behalf of the workforce and threaten violence if their demands were refused. Labor would then transfer their loyalties to the Maoist unions, squeezing industry. Laxman Basnet, President of the Nepal Trade Union Congress (NTUC), who was somewhat dismissive of the Maoist's long-term chances, did admit that the Maoists were having some success in union busting.

¶5. (SBU) Vice Chairman Bishnu Rimal of the General Federation of Nepalese Trade Unions (GEFONT) provided a radically different view. He claimed that business owners were calling in the Maoists and negotiating with them to bust up the established unions. After the Maoist demands were satisfied, the other unions would demand the same for their own membership, which the owners were now in no position to refuse. He cited several specific instances and noted that the current President of the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) often met with the Maoists.

#### CAPITAL FLIGHT A SERIOUS PROBABILITY

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¶6. (SBU) At a roundtable discussion with industrialists in Birgunj, one participant stated that 50 percent of the business owners in the town -- Nepal's industrial capital -- would sell if they could find a buyer (ref A). His compatriot corrected him in gallows humor fashion by stating that 50 percent would simply close if the law permitted it. Prominent leaders of the Marwari and Newari business communities in Kathmandu have acknowledged to the Ambassador that they are trying to get as much capital as quickly out of the country as possible.

#### BUSINESS COMMUNITY LACKS VISION FOR ECONOMIC POLICIES...

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¶7. (SBU) INR analysts heard that business input to the GON on economic policy was very weak. At several meetings and roundtables, the plea was made for the diplomatic community to take the message to the GON because the business communities own efforts were ineffectual. Leaders of the two largest labor unions (the Nepali Congress-affiliated NTUC and the United Marxist-Leninist-affiliated GEFONT) had better access to senior leaders of their associated parties, but had no confidence that their requests or appeals would be acted upon either.

¶8. (SBU) More depressing, however, was the utter lack of economic policy vision for the future offered by most of the business community when asked what they would request from a stable government should it emerge. Rewat Karki, General Manager of the Nepal Stock Exchange, suggested reform of the manufacturing/industrial sector, including standardized accounting and more transparent business practices, while a few others suggested reforming the labor laws to allow "hire-and-fire" practices. Most, however, indicated it was a "political decision." Karki said that industrialists were adopting a "wait-and-see attitude" on further investment until they saw how the current political situation was resolved. According to Karki, only the financial sector, including private banks and insurance companies, was showing a profit, while

companies in the manufacturing/industrial sector were languishing.

#### ...BUT AGREE INEQUALITY INHIBITS ECONOMIC GROWTH

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¶9. (SBU) Most businessmen mentioned that stark social inequality in Nepal was a serious problem that had to be solved in order to pave the way for long-term economic growth and reduce the appeal of the Maoists. As a result, economic policy in the next couple of years might have to be focused on providing social services -- similar to the last budget which focused on welfare issues and lacked incentives for businesses or any mention of export promotion (ref B). Rajendra Khetan, a leading industrialist, even expressed support for land redistribution. Most government officials and private businessmen acknowledged that Maoist ideology appealed to disadvantaged members of society -- people who have limited opportunities under the current social structure.

#### NO POLITICAL WILL TO SOLVE PETROLEUM CRISIS

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¶10. (SBU) Bhanu Acharya, head of the three-member panel the GON tasked with formulating a plan to handle the petroleum price crisis (ref C), stated that the political parties recognized that the government could not afford to continue subsidizing petroleum prices. However, the GON lacked the political will to bring domestic prices in line with market prices. He noted that petroleum pricing was an extremely emotional issue in Nepal and that every price change had been accompanied by protests "for decades." Kerosene and cooking gas were the most sensitive, but increases in diesel and gasoline caused anxiety even among those who rarely used them because of fears that higher transportation costs would fuel inflation.

¶11. (SBU) Acharya expected that the petroleum panel's report, which should be sent to the cabinet within the next few weeks, would lay out the reality of the situation. (Note: The report was presented to the cabinet on September 21 and has not been made public yet. End Note.) He said it would likely recommend targeted subsidies by product --especially kerosene -- and recommend sufficient price hikes to begin to pay down the NPR 4 billion (USD 54 million) the Nepal Oil Corporation (NOC) owes Nepal's state-owned banks. Then, based on the new pricing scheme, the GON would try to negotiate a better supply deal with the Indian Oil Corporation (IOC), which NOC owes NPR 8 billion (USD 108.1 million). Acharya intimated that the panel report might provide the cover the government needed to begin to educate the public on the need for, and inevitability of, petroleum price hikes.

#### TRADE WITH INDIA AND BEYOND

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¶12. (SBU) Prachanda Man Shrestha, Joint Secretary in the Ministry of Commerce, explained that the current trade regime with India was virtually free trade and that India's attitude toward Nepal -- traditionally that of a bully -- was changing. The Indians, he noted, were playing fair by giving Nepal unhindered access to the Calcutta port to run trains from Calcutta to the Internal Cargo Depot (ICD) in Birgunj.

¶13. (SBU) Shrestha opined that the South Asian Free Trade Area (SAFTA) had little real chance of success, because India's interests had turned toward trade with the Association of South-East Asian Nations (ASEAN). This Indian interest, however, gave the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation's free trade agreement (BIMSTEC FTA) a real shot at emerging as the center of regional trade (ref D). The Joint Secretary noted that an increase in trade between Thailand and India via BIMSTEC would indirectly benefit Nepal's economy. BIMSTEC had the added advantage

of not burdening India and other members with baggage from the Indo-Pakistani rivalry.

#### CHINA TRADE: HOW SERIOUS?

¶14. (SBU) Shrestha mentioned that Nepal, located between India and China, could not help but benefit from transit trade. When it was suggested that Nepal was, in fact, far from the markets in both India and China, he grinned and said, "You're right. Nepal is not between India and China, but between Tibet and Bihar." (Note: Bihar is one of India's poorest states. End Note.) More promising, he thought, was an East-West railway in Nepal that could foster India-Nepal-India trade. (Note: At a subsequent meeting at the Department of Industry, an official there confirmed that raising foreign investor interest in such a railway was a priority. End Note.)

#### COMMENT

¶15. (SBU) Business leaders and government officials are preoccupied with the political situation and are waiting to make private investment and economic policy decisions until the Maoist insurgency has been resolved. The key players in the political arena -- the Seven Party Alliance and the Maoists -- are far from reaching consensus on a common economic policy which could allow the economy to grow despite political uncertainty during this transition period. In the absence of political stability, entrepreneurs are unlikely to resume investment, and economic growth will likely remain very low.

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